

JERROLD OPPENHEIM
57 Middle Street
Gloucester, Mass. 01930
+1(978)283-0897 . Fax +1(978)283-0957 . JerroldOpp@tgic.net

June 14, 2001

Mary Cottrell, Secretary
Department of Telecommunications and Energy
One South Station
Boston, Mass. 02110

RE: Technical Session re: Competitive Market Issues

Dear Secretary Cottrell:

These are the written comments of the Massachusetts Community Action Directors Association, Inc. (MASSCAP) and the Low-Income Energy Affordability Network (LEAN), pursuant to the notice of Technical Session (May 10, 2001) and the notice inviting written comments (May 31, 2001 e-mail). As requested, 15 copies are enclosed and these comments are also filed electronically.

LEAN is a voluntary association of the lead agencies of the Low-Income Weatherization and Fuel Assistance Program Network, which is described in St. 1997, c. 164 (the Restructuring Act), Sec.37, G.L. c. 25. Sec. 19, and which implements about \$20M a year of low-income efficiency measures pursuant to programs sponsored by every Massachusetts electric utility, nearly every Massachusetts gas utility, the U.S. Department of Energy (DOE), and the Massachusetts Department of Housing and Community Development (DHCD). Most members of the Network are community action programs, the directors of which are incorporated as MASSCAP. LEAN and the community action programs are deeply rooted in low-income communities and in this country's commitment to battling poverty.

MASSCAP and LEAN are grateful for this opportunity to share their views with the Department, especially since, due to scheduling conflicts, they were unable to participate in the May 31 Technical Session.

INTRODUCTION AND SUMMARY

As the notice instituting this proceeding pointed out, retail electricity competition has been extremely slow to develop despite the Restructuring Act. As detailed below, wholesale and retail electricity commodity prices have risen dramatically (quadruple and triple, respectively) with almost no choice for residential customers. The low-income discount rate (R-2) codified by the Restructuring Act has been important to low-income

consumers in partially mitigating these adverse impacts. However, the discount reaches only about 26% of the families eligible for it, according to data reported by the Division of Energy Resources (DOER). Furthermore, at least 25% of the low-income families not reached by the low-income discount have moved since the beginning of restructuring and are therefore also not protected by the Standard Offer.¹ Applying these percentages to the latest estimate by the Massachusetts Institute of Social and Economic Research (MISER) of the number of low-income families in the Commonwealth,² more than 100,000 Massachusetts low-income families are currently subjected to the relatively high market rate reflected in Default Service rates – which have tripled since restructuring. As noted by the Department, the number of default customers is growing. If present trends continue, once the Standard Offer expires (assuming it is not extended by the Department or the General Court), more than 400,000 low-income families will be subjected to the rising and volatile prices of Default Service and will have no alternatives thereto.

Electricity prices are particularly important to low-income families because electricity bills represent about triple the fraction of their income when compared to the burden of electricity bills on median income families. Furthermore, the income of low-income families has been declining, which puts added economic pressure on people who already have difficulty making ends meet. The further additional impact of the natural gas price increases of the last year, and oil heat prices the year before, has been crushing.

In its notice, the Department asks whether there are regulatory barriers inhibiting default service customers and competitive suppliers from finding each other. We observe that there are more than 500,000 default service customers and that the number is growing, yet there is not a single residential supplier in the marketplace (other than one internet-based offer that bundles telephone service). This suggests that the barriers that exist apply to potential suppliers entering the marketplace rather than to the supplier-customer relationship. The reason residential customers and competitive suppliers are not finding each other is that there are no residential suppliers to find. The reason that there are no residential competitive suppliers, we submit, is that the wholesale marketplace is not operating in a competitive manner and is therefore not attractive for potential competitive retailers.

Thus the “challenge of animating the competitive retail market” that the Department sets forth requires addressing the wholesale market. In the balance of these comments, we will first illustrate the difficulty presented by the current wholesale electricity market in New England, which has been characterized by prices that are both extremely volatile and rising to levels that are substantially in excess of the cost of production. We then address the tools that the Department has to address the wholesale electricity market failure. As detailed below, we submit that:

¹ According to the notice initiating this proceeding, about 25% of customers are now on Default Service. Low-income families move about twice as often as others, so the percentage of non-R-2 low-income families on Default Service is likely higher.

² Memo from Jim Westrich to Jerrold Oppenheim, June 14, 2001, estimating number of households in 1998-1999 with incomes at or below 175% of the Federal Poverty Line, which is the standard established in the Restructuring Act for low-income discount eligibility.

- Low-income families need immediate relief from rising prices, including greater outreach efforts with respect to the low-income discount rate as well as expanded discounts and protections such as shut-off moratoria.
- Various proposals that do not address the wholesale electricity market failure will not repair that failure. Such proposals include bidding out default service provision and artificially raising retail prices.
- The Department has powerful tools at its disposal to address the wholesale market failure. These include its oversight of default service purchasing, its ability to require utilities to build plant if that is the most prudent option, and its oversight of demand-side management and demand response programs.

Thus, we submit, if the Department's aim is to establish effective retail competition, it must first do all that it can to bring effective competition to the underlying wholesale market. In the meantime, the Department should take the actions it can to alleviate the harm that market failures are imposing on low-income families.

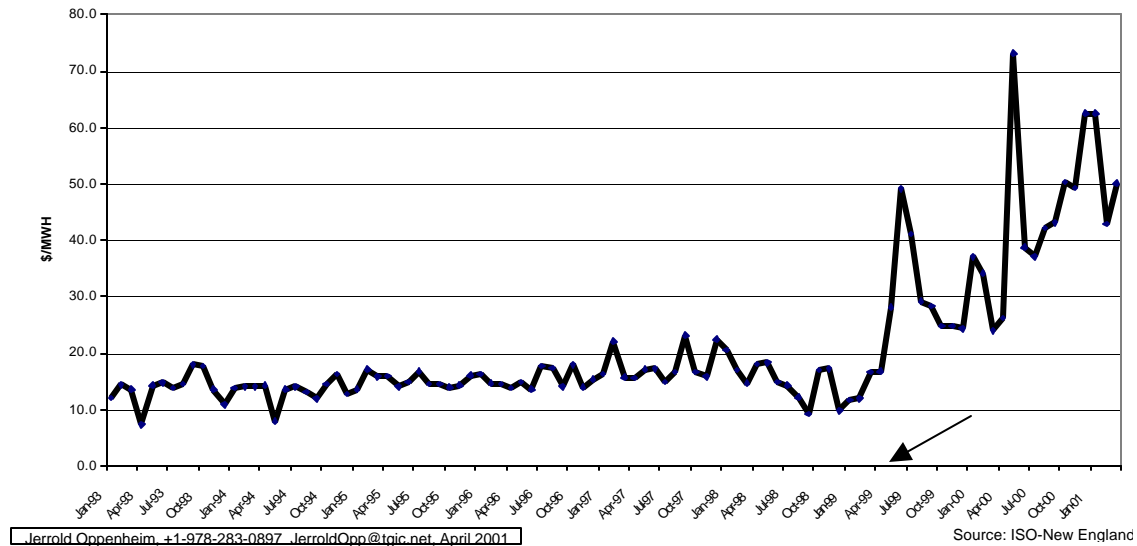
THE NEW ENGLAND WHOLESALE ELECTRICITY MARKET

On average, New England wholesale electricity prices in the year 2000 increased 58% faster than is explained by gas and oil price increases. Less than half of New England electricity is generated by gas and oil, accounting for a cost increase of about 25%. Yet electricity prices rose by about 40%. Estimates of market overcharges are in the billions of dollars for the year 2000 alone.

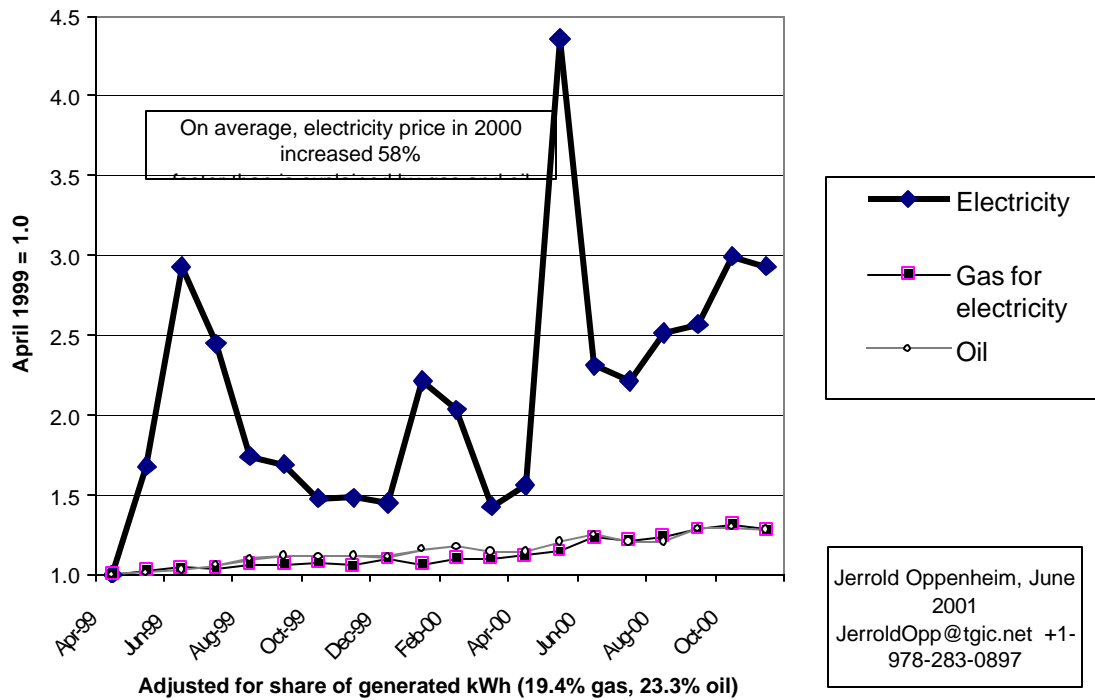
Since the New England marketplace opened, the wholesale price of electricity has quadrupled over the pre-market average. Furthermore, volatility has increased about 70%.

Volatility is particularly difficult for low-income families to manage since their limited incomes make careful budgeting a necessity. Volatility also substantially increases the risk to retailers since they cannot accurately predict their largest cost.

New England Average Monthly Wholesale Electricity Price



New England Electricity Prices from Market Opening Compared to Gas and Oil Prices



Source: US Energy Information

Roughly speaking, the difference between Standard Offer and Default Service prices can be viewed as a measure of the difference between regulated and market rates. Depending on the utility, retail market electricity thus costs 40% more than regulated electricity. Even if this were accompanied by choices – which it is not – consumers do not view this as a successful outcome of restructuring. For many low-income customers, already threatened by dropping incomes and skyrocketing heating bills, such electricity price increases threaten their ability to maintain electricity service at all.

LOW-INCOME RELIEF

Whatever may be done in the medium and long terms to repair the marketplace, low-income families need immediate relief. The most obvious step is to implement the assistance that the Department and General Court have already provided, the low-income discount. Although the Restructuring Act requires “substantial outreach” with respect to this benefit, the penetration of the discount actually declined.

In cooperation with LEAN, and in coordination with efficiency programs under the Restructuring Act, all electric utilities in the Commonwealth are now increasing their outreach efforts. We ask that the Department continue to monitor the results of these efforts.

However, electricity price increases have been difficult even for those receiving Standard Offer service and the low-income discount. In effect, Standard Offer price increases have in some cases more than wiped out the 15% discount provided by the General Court. Low-income families under increasing economic pressure will need more consideration with respect to payment arrangements and disconnection moratoria.

Ultimately, there is a need to increase the low-income discount in order to make it possible for low-income customers to continue paying their bills.

PROPOSALS THAT DO NOT ADDRESS THE WHOLESALE MARKET

We submit that proposals that have been made that do not address deficiencies in the wholesale market will not repair the deficiencies therein and will therefore not bring the retail markets any closer to fulfilling the promise of lower prices from competitive markets.

Thus, for example, replacing the utility with a different provider of default service will do nothing to change the structure of the marketplace. Similarly, government-arranged slamming of default customers by allocating them to various suppliers will do nothing for the wholesale market while at the same time it will confuse and anger consumers.

Artificially raising retail prices, such as by adding in customer acquisition costs, would simply confirm the worst fears of consumers that the true impact of competition is to add new costs and permanently raise prices. It would amount to an unlawful subsidy of retail competitors and would do nothing to address the wholesale market deficiencies of volatile and rising prices. Indeed, such a strategy would simply accept wholesale market deficiencies and represent an attempt to create retail competition – without wholesale competition – at consumers’ expense.

Furthermore, there is substantial evidence that the strategy would not even work to create retail competition. The restructuring strategy in Pennsylvania included long-term utility price caps that were set at what appeared to be high levels in order to provide “headroom” for competitors to offer lower prices. With the exception of the Philadelphia area (where the outcome remains uncertain), residential retail competition has disappeared from Pennsylvania as wholesale prices rose to eliminate the margin that had been artificially created. As in other states that restructured, Pennsylvania failed to address the need to assure effective wholesale competition and that failure brought about the failure of residential retail competition.

TOOLS TO ADDRESS THE WHOLESALE MARKETPLACE

Although the wholesale electricity market is not directly within the Department’s jurisdiction, the Department nevertheless has effective tools to affect that marketplace. The most direct tool is its control over Default Service procurement.

The Restructuring Act requires that Default Service pricing be based on the “market,” but not on the spot market. As the regular increases in the price of Default Service attest, the Department’s current policy of limiting purchases to six-month periods nearly replicates the spot market. However, six months is the minimum pricing period required by the statute. Nothing in the Restructuring Act prohibits the Department from protecting Default Service customers by requiring a prudent portfolio of resources that includes a mix of contract periods. The California and Massachusetts experiences demonstrate that spot, and near-spot short term, purchasing leads to the most volatile and, so far at least, highest, prices. Upstate New York utilities (Niagara Mohawk Power Corp. and New York State Electricity & Gas Co.), by contrast, are protecting their customers during this transition period by maintaining portfolios of wholesale resources over varying contract lengths, which permits the utilities to offer relatively stable prices over time.

If California proved nothing else, it showed that total reliance on a spot market can be economically catastrophic. Yet, as Default Service evolves into the only residential electricity service in Massachusetts, current Department purchasing policy is leading us into almost exactly the same situation. Six month contracts are (not surprisingly) proving to be only slightly less volatile and costly than spot, but, under current policy, as Standard Offer expires all Massachusetts residential electricity will be provided under Default Service six month contracts.

In order to remove the ability of the spot market to control Massachusetts electricity prices, the Department should move a substantial fraction of purchases into longer term contracts.

If reasonable prices cannot even be obtained over longer term contracts, then the Department should consider whether the most prudent purchasing policy is to build rather than to buy. A small number of utility-owned cost-of-service plants may be the most effective wholesale market discipline. In other words, the Department should consider addressing the lack of effective wholesale market competition by introducing effective price competition into the wholesale market. We have been told that, in theory, wholesale markets will ultimately charge marginal cost for electricity. What better test, then, than to introduce into the market a plant that competes by charging no more than the cost of service.

In addition to the supply side of the wholesale market, prices are influenced by demand. The Department oversees, with the DOER, a large electricity efficiency program that reduces demand as well as consumption. In addition, the Department should coordinate with DOER's efforts to establish programs that are focused on demand management. As studies by DOER, the Edison Electric Institute, and others have shown, a relatively small decrease in demand – especially at times of system peak and near-peak – can have a very large impact on the wholesale price of electricity, especially where (as in New England) all spot kWh are sold at the highest bid price. Reducing demand reduces the highest bid price, which reduces the price for all kWh sold on that hour. Therefore a demand reduction program that focuses on a relatively small number of very large-demand customers can have a large and very cost-effective impact on price, *i.e.*, on the competitiveness of the wholesale market. Demand is thus an important part of the competitive mix.

CONCLUSION

So far, the most significant results of Massachusetts electricity restructuring that a residential consumer can point to are higher and more volatile prices with no choice. On this basis, restructuring to date cannot be counted a success. For many low-income families, it has been a significant part of an energy catastrophe.

However, the principal cause of this failure has not been the retail market established by the Restructuring Act. Rather, the principal cause of the failure of Massachusetts restructuring to date has been the failure of the New England wholesale marketplace that the Restructuring Act made possible. While it is true that this marketplace is no longer within the Commonwealth's jurisdiction, it is not true that the Commonwealth lacks tools to deal with it.

In order to address wholesale market failures, the Department should reconsider its policy of exclusive short-term purchases for Default Service. It should also begin consideration

of whether a small addition of cost-of-service competition in the wholesale market would make that market more competitive than it is now. Additional competition should also be provided on the demand side.

Most immediately, the Department should take steps to alleviate the burden of restructuring on low-income families, including by increased utility outreach with respect to the low-income rate, revised payment and disconnection policies, and an increased low-income discount.

Respectfully submitted,

Massachusetts Community Action Directors Association, Inc.
Low-Income Energy Affordability Network
By their attorney

Jerrold Oppenheim

cc:

dte.efiling@state.ma.us

jeanne.voveris@state.ma.us